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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 751

MUTUAL SHOE COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Mutual Shoe Company, by its undersigned attorney, respectfully prays for a writ of certiorari to The United States Court of Appeals for the First Circuit in the foregoing cause.

OPINION BELOW

The opinion of the United States Court of Appeals for the First Circuit was rendered on November 9, 1956 (R-A25-A33) and remains unreported as of this date. Said opinion is contained herein in the Record pages A-25 to A-33.

JURISDICTION

The Judgment of the First Circuit sought to be reviewed was entered on November 9, 1956 (R. A-34).

Jurisdiction is conferred upon the Supreme Court of the United States to review this cause by Sections 1254(1) and of the Judicial Code (Title 28, U.S.C.A.) as enacted June 25, 1948; and, the petition is timely within the purview of Section 2101(c) of the Judicial Code (Title 28, U.S.C.A.)

QUESTION PRESENTED

1. Is the amount of normal tax net income—correctly determined according to statute—of a corporation subject to income tax under the Internal Revenue Code of 1939 as amended by the Revenue Act of 1942, subject to change upon such corporation applying for and receiving partial relief from Excess Profits Tax pursuant to Section 722 of said code; or, does the subsequent grant of partial relief from Excess Profits Tax lack retroactivity.

The Tax Court of the United States and the Court of Appeals for the First Circuit held it was retroactive and did change the amount of normal tax net income.

We maintain it is not retroactive and does not change the amount of normal tax net income.

STATUTES INVOLVED

The statutes involved are set forth in verbatim in Appendix A hereof. They are:

Internal Revenue Code of 1939 as amended by the Revenue Act of 1942: Sections 13, 15, 26, 710, 711, 712, 713, 714, 722, 728, 729.

Treasury Regulations 111, Section 29, 26-4 and Regulations 112, Section 35, 722-2.

STATEMENT OF THE CASE

The petitioner is a corporation organized under the laws of the State of Massachusetts; and filed its income tax returns, excess profits tax returns and declared value excess profits tax returns for the years here involved, that is for the fiscal years ending on May 31, 1943, 1944, and 1945 with the Collector of Internal Revenue for the District of Massachusetts at Boston, Massachusetts.

The petitioner in preparing its excess profits tax return determined it Excess Profits Credit on the Invested Capital Method.

Subsequently, the petitioner filed claims for relief from excess profits taxes, which claims were allowed in part, such allowance being based upon a constructive average base period net income of $22,360.00. There is no dispute about the relief allowed to the petitioner under section 722 of the Internal Revenue Code of 1939 as Amended by the Revenue Act of 1942.

Upon granting the aforesaid partial relief from excess profits tax under Section 722, the Commissioner asserted additional income taxes for each of the three years, as follows:

fiscal year ending May 31, 1943 in the amount of	$2,008.52
fiscal year ending May 31, 1944 in the amount of	$1,781.23
fiscal year ending May 31, 1945 in the amount of	$1,535.90
a total for the three years of	$5,325.65

on the theory that the granting of relief, freeing a part of the earnings from excess profits tax, correspondingly increased the amount of earnings subject to the income tax.

We find no provision of law authorizing the increase of earnings subject to income tax, upon the allowance of relief from part of the excess profits tax; and, the Commissioner disagreeing, under date of April 10, 1951 issued the statutory notices of deficiency in the aforesaid amounts.

The petitioner thereupon filed a petition with The Tax Court of the United States pursuant to jurisdiction conferred by Section 272 of the Internal Revenue Code of 1939; and that Court, on December 14, 1955, promulgated its opinion upholding the Commissioner. Decision was entered on December 16, 1955.

The petitioner thereupon filed an appeal with the United States Court of Appeals for the First Circuit and that Court affirmed the decision of the Tax Court on November 9, 1956.

This is a case of first impression. The issue here raised by the petitioner has not been passed upon by any Court other than in this case. The Tax Court and the Appellate Court, like ourselves, were unable to find any provision of law in support of their position; however, both relied upon the broad principle that the Congress intended to divide income into two parts—part subject to the excess profits tax, and the

balance subject to the income tax. That broad principle is correct—but here Congress made an exception. It considered this broad principle here; but, deliberately rejected it by deleting section 722 corporations from those to which a special rule was applied, and left situations such as this to have the income tax determined without regard to relief. The Courts below, contrary to the rationale of *United States* v. *Koppers Company,* 348 U.S. 254 have given relief retroactive effect.

ARGUMENT

The issue here raised is one of law, and it is a case of first impression. It is a federal question of federal tax law not heretofore determined by this Court; and appears to be in conflict with the rationale of the *United States* v. *Koppers Company, Inc.* 348 U.S. 254, decided January 31, 1955.

It is a question that is current—a great number of cases still pending in the office of the Commissioner of Internal Revenue and The Tax Court of the United States involving some millions of dollars will be affected by the outcome of this case. Therefore certiorari should issue so that the question may be set at rest.

The question involves the income tax of a corporation during the years that the excess profits tax was in effect—it does not involve the excess profits tax. It affects the income tax of corporations who sought and were granted relief from a discriminatory excess profits tax during the years 1942 to 1945. Where relief from a discriminatory excess profits tax was procured, the Commissioner concluded that to the ex-

tent that income was relieved of excess profits tax it was to be subjected to income tax.

Neither of the Courts below were able to point to any statutory provision in support of the Commissioner's action; but, nevertheless, concluded that such was the intent of Congress, despite the rejection of such principle by the Conference Committee of the Congress in reconciling the House and Senate versions of the Revenue Act of 1942.

The issue arises in the following manner:

Under the Revenue Act of 1942 corporations were required to file an income tax return and an excess profits tax return and compute their tax in the standard way without recourse to any relief. The tax so computed was required to be paid.

In substance, the income was divided into two parts—one part subject to excess profits tax and the other subject to income tax. The taxpayer, if he considered his excess profits tax excessive and discriminatory was privileged to file a claim for relief from excess profits tax in accordance with Section 722 of the Internal Revenue Code.

Thereupon the claim was processed, negotiations conducted and, in cases where this issue arises, the taxpayer was granted relief by refund of part or all of his excess profits tax. The mechanics to accomplish this was the substitution for the base period net income or the credit on invested capital, of a constructive average base period net income for excess profits tax purposes only (Section 722, IRC)

The Commissioner, however, despite the absence of any section of law, upon granting such relief from

excess profits tax determined that the amount so released from excess profits tax was subject to income tax, and years later—here six years later—retroactively imposed an additional income tax. The following example will illustrate the issue.

	Petitioner	Respondent
Adjusted Net Income	$84,	$84,
50% of Interest on Borrowed Capital	2,	2,
Excess Profits Net Income	86,	86,
Less:		
Specific Exemption	5,	5,
* Excess Profits Credit based on Invested Capital	19,	0,
** Constructive Average Based Period Net Income pursuant to Section 722		22,
Total Deduction	24,	27,
Adjusted Excess Profits Net Income	62,	
Balance:		59,
Adjusted Net Income as above	$84,	$84,
Income subject to excess profits tax as above	62,	59,
Normal Tax Net Income	$22,	$25,

The deficiency here involved results from the larger figure determined by the Respondent's method of computation. It will be noted that the change results from the substitution of the Constructive Average Base Period Net Income, marked ** above for the Excess Profits Credit Based on Invested Capital, marked * above.

In the *United States* v. *Koppers Company, Inc.*, 348 U.S. 254 the Commissioner on the subject of interest took a contrary position and was upheld by this Court.

There (p. 261) this Court said:

> "The Commissioner, on the other hand, contends that the determination under § 722 is not retroactive but is a current abatement effective when made."

Here we likewise claim that the adjustment is not retroactive.

More directly in point is the following analysis made by this Court in the *Koppers* case. It said at pages 263-4:

> "The interest here in controversy was due under § 292(a) from March 15, 1941, until paid. Accordingly, to obtain a refund of it, the taxpayer must sustain the proposition that the tax relief granted under § 722 is necessarily retroactive, extinguishing the deficiency as of the original due date of the tax and thus eliminating the interest charges for the corresponding period. To that end, the taxpayer emphasizes the statement in § 722(a) that, as a condition of securing the application of § 722, a taxpayer must establish that the usual procedure 'results in an excessive and discriminatory tax' and also must establish 'what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income.' Once the taxpayer has done that, 'the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter.' Standing alone, this directive language is elastic. It can be read consistently either with the interpretation that the new computation replaces and abates the old one currently, when the new one is determined and assessed, or that it retroactively replaces the old tax from its original due date. It leaves the issue open for disposition by the effect

of other clauses relating more specifically to the issue. For the reasons hereinafter stated, we read it looking forward, rather than backward."

Applying here the same rule, that is the effect of other clauses relating more specifically to the issue, we must again look forward rather than backward.

Section 26(e) controls the credit to be allowed. It includes four exceptions, and Section 722 cases is not included as an exception. In the House bill, Section 722 cases were included as one of the exceptions; and it was eliminated by the Senate. The Finance Committee in its report No. 1631 to the Senate states: (Cum. Bul. 1942-2, p. 556)

> "Corporations reconstructing average base period net income under section 722 have been removed from this special category and, by reason of the amendments made to section 722 by section 221 of your committee bill, will come under the general rule making the credit under section 26(e) the amount of adjusted excess profits net income."

Later the Conference Committee made its report on October 19, 1942. In its Report No. 2586 (2nd Sess. 77th Congress) it states (Cum. Bul. 1942-2, p. 702):

> "Amendment No. 14: This amendment changes the House provision with respect to the credit of corporations in computing normal tax and surtax for income subject to excess profits tax. Under the House bill, the general rule is that a corporation subject to excess profits tax shall be entitled to a credit in an amount equal to its adjusted excess profits net income. Certain exceptional situations are set forth in which the amount of credit shall be the amount of which the excess profits tax imposed under the particular section making the exception is 90 per cent. The House

bill includes within this exception the cases of corporations computing excess profits tax under sections 721 and 726. The Senate amendment eliminates from the exception provided in the House bill the case of a corporation computing its excess profits tax under section 722 and adds to the exception corporations computing excess profits tax under sections 731 and 736(b)."

The legislative record, therefore, fully supports the position of the petitioner. Congress, in all its wisdom, after full consideration of the subject, concluded that the "adjusted excess-profit net income" credit for corporations procuring relief under section 722, should be the "adjusted excess-profits net income" allowed to corporations not the beneficiaries of 722 Relief. The House first thought otherwise, the Senate eliminated the restriction and the House receded from its position.

CONCLUSION

We therefore urge the Court to grant certiorari. This is a question of great importance in the administration of the tax laws that has not been decided by this Court, but should be, because, what this Court has said in *United States* v. *Koppers Company, Inc.* 348 U.S. 254 clearly sustains our claim that the Court below decided the question wrong.

WHEREFORE, your petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the First Circuit, commanding that Court to certify and send to this Court on a day to be determined a full and complete transcript of the record of all the proceedings of such Court of Appeals had in this cause, to the end that the proceedings and decision

therein may be reviewed and determined by this Court; that the judgment of the Court of Appeals may be reversed; and that the petitioner be granted such other and further relief as may seem proper.

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APPENDIX A

Internal Revenue Code of 1939:

CHAPTER 1—INCOME TAX

* * * * *

SUBCHAPTER B—GENERAL PROVISIONS

Part I—Rates of Tax

* * * * *

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) [as amended by Sec. 201 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 105(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definitions.*—For the purposes of this chapter—

(1) *Adjusted net income.*—The term "adjusted net income" means the net income minus the credit provided in section 26(a), relating to interest on certain obligations of the United States and Government corporations.

(2) *Normal-tax net income.*—The term "normal-tax net income" means the adjusted net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26(b).

(b) [as amended by Sec. 101(a) of the Second Revenue Act of 1940, c. 757, 54 Stat. 974] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231(a), Supplement G, or Supplement Q) whichever of the following taxes is the lesser:

(1) [as amended by Sec. 103(a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General rule.*—A tax of 24 per centum of the normal-tax net income; or

* * * * *

(26 U.S.C. 1952 ed., Sec. 13.)

SEC. 15 [as amended by Sec. 105(b) of the Revenue Act of 1942, *supra*]. SURTAX ON CORPORATIONS.

(a) *Corporation Surtax Net Income.*—For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e) and minus the credit for dividends received provided in section 26(b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends, paid on its preferred stock provided in section 26(h). * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the corporation surtax net income of every corporation (except a Western Hemisphere Trade Corporation as defined in section 109, and except a corporation subject to the tax imposed by section 231(a), Supplement G, or Supplement Q), a surtax as follows:

(1) *Surtax net incomes not over $25,000.*—Upon corporation surtax net incomes not over $25,000, 10 per centum of the amount thereof.

(2) *Surtax net incomes over $25,000 but not over $50,000.*—Upon corporation surtax net incomes over $25,000, but not over $50,000, $2,500, plus 22 per centum of the amount of the corporation surtax net income over $25,000.

(3) *Surtax net incomes over $50,000.*—Upon corporation surtax net incomes over $50,000, 16 per centum of the corporation surtax net income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 15.)

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(e) [as amended by Sec. 105(d) of the Revenue Act of 1942, *supra*, and Sec. 202(c) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Income Subject to Excess-Profits Tax.*— In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b)). In the case of any corporation computing such tax under section 721 (relating to abnormalities in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736(b) (relating to corporations with income from long-term contracts), the credit shall be the amount of which the tax imposed by such subchapter is 95 per centum. For the purpose of the preceding sentence the term "tax imposed by Subchapter E of Chapter 2" means the tax computed without regard to the limitation provided in section 710(a)(1)(B) (the 80 per centum limitation), without regard to the credit provided in section 729(c) and (d) for foreign taxes paid, and without regard to the adjustments provided in section 734. This subsection shall not apply to any corporation exempt from such tax under section 725 or section 727.

* * * * *

(26 U.S.C. 1952 ed., Sec. 26.)

CHAPTER 2—ADDITIONAL INCOME TAXES

* * * * *

SUBCHAPTER E—EXCESS PROFITS TAX

[As added by Sec. 201 of the Second Revenue Act of 1940, *supra*, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"].

SEC. 710. IMPOSITION OF TAX.

(a) [as amended by Sec. 201 (a) of the Revenue Act of 1941, *supra*, and Sec. 202 of the Revenue Act of 1942, *supra*] *Imposition.*—

(1) *General rule.*—There shall be levied collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) [as amended by Sec. 202 (a) of the Revenue Act of 1943, *supra*] 95 per centum of the adjusted excess-profits net income, or

(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter).

* * * * *

(b) [as amended by Sec. 2 (a) of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and by Sec. 204 (a) of the Revenue Act of 1942, *supra*] *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in Section 711) minus the sum of:

(1) [as amended by Sec. 204 of the Revenue Act of 1943, *supra*] *Specific exemption.*—A specific exemption of $10,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under Section 712; and

(3) *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

* * * * *

(26 U. S. C. 1952 ed., Sec. 710.)

SEC. 711. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the Excess profits credit is computed under section 713, the adjustments shall be as follows:

(A) [as amended by Sec. 206 (a) of the Revenue Act of 1942, *supra*] *Income Subject to Excess Profits Tax.*—In computing such normal-tax net income the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profit credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(26 U.S.C. 1952 ed., Sec. 711.)

SEC. 712 [as amended by Sec. 13 of the Excess Profits Tax Amendments of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 712.)

SEC. 713 [as amended by Sec. 4 of the Excess Profits Tax Amendments of 1941, *supra*, and Sec. 228 (e) (2) of the Revenue Act of 1942, *supra*]. EXCESS PROFITS CREDIT —BASED ON INCOME.

(a) *Amount of Excess Profits Credit.*—The excess profits credit for any taxable year, computed under this section, shall be—

(1) *Domestic corporations.*—In the case of a domestic corporation—

(A) 95 per centum of the average base period net income.

* * * * *

(b) *Base Period.*—

(1) *Definition.*—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

* * * * *

(26 U. S. C. 1952 ed., Sec. 713.)

SEC. 714 [as amended by Sec. 205 of the Revenue Act of 1943, *supra*]. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715 is:	The credit shall be:
Not over $5,000,000.	8% of the invested Capital.

* * * * *

(26 U. S. C. 1952 ed., Sec. 714.)

SEC. 722 [as amended by Sec. 222 of the Revenue Act of 1942, *supra*]. GENERAL RELIEF—CONSTRUCTION AVERAGE BASE PERIOD NET INCOME.

(a) *General Rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter.

* * *

(b) *Taxpayers Using Average Earnings Method.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant

to section 713, if its average base period net income is an inadequate standard of normal earnings because—

(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

(2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry,

(3) the business of the taxpayer was depressed in the base period by reason of conditions generally prevailing in an industry of which the taxpayer was a member, subjecting such taxpayer to

(A) a profits cycle differing materially in length and amplitude from the general business cycle, or

(B) sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period,

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflect the normal operation for the entire base period of the business. * * * or

(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.

(c) *Invested Capital Corporations, Etc.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer, not entitled to use the excess profits credit based on income pursuant to section 713, if the excess profits credit based on invested capital is an inadequate standard for determining excess profits, because—

(1) the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income,

(2) the business of the taxpayer is of a class in which capital is not an important income-producing factor, or

(3) the invested capital of the taxpayer is abnormally low.

In such case for the purposes of this subchapter, such taxpayer shall be considered to be entitled to use the excess profits credit based on income, using the constructive average base period net income determined under subsection (a). * * *

(d) *Application for Relief Under This Section.*—The taxpayer shall compute its tax, file its return, and pay its tax under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribed the extent to which the limitations prescribed by this subsection may be waived

for the purpose of determining the tax under this subchapter for a subsequent taxable year.

* * * * *

(g) [as added by Sec. 206 of the Revenue Act of 1943, *supra*] The Commissioner shall compile for each fiscal year beginning after June 20, 1941, by internal revenue districts, and alphabetically arranged, all cases in which relief has been allowed during such year under the provisions of this section by the Commissioner and by The Tax Court of the United States, as the case may be. Such compilation shall contain the name and address of each taxpayer to which relief has been so allowed, the business in which the taxpayer is engaged, the amount of the excess profits credit before such allowance, the increase in such credit claimed, the increase in such credit allowed, and the amount of the gross reduction in the tax under this subchapter and of the gross increase in the tax under Chapter 1, which results from the operation of this section. In the case of relief allowed by The Tax Court of the United States, the Commissioner shall also set forth the data previously reported under this subsection with respect to relief previously allowed in such case by the Commissioner. Such compilation shall be published in the Federal Register.

(26 U. S. C. 1952 ed., Sec. 722.)

SEC. 728. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

(26 U. S. C. 1952 ed., Sec. 728.)

SEC. 729. LAWS APPLICABLE.

(a) *General Rule.*—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this

subchapter, be applicable in respect of the tax imposed by this subchapter.

* * * * *

(26 U. S. C. 1952 ed., Sec. 729.)

Treasury Regulations 111, Promulgated Under the Internal Revenue Code of 1939. October 28, 1943:

Sec. 29.26-4 [as amended by T. D. 5401, 1944 Cum. Bull. 204, 206]. *Credit for Income Subject to Excess Profits Tax.*—A credit is provided in section 26 (e) allowable under sections 13 (a) (2) and 15 (a) in computing normal tax net income and surtax net income, respectively. See section 108 as to certain fiscal years. The credit is allowed only in the case of corporations subject to the excess profits tax imposed by Subchapter E of Chapter 2. The credit does not apply to a corporation exempt from such tax under section 725 (relating to personal service corporations) or section 727 (relating to corporations exempt from excess profits tax).

In general, the credit is the amount of the corporation's adjusted excess profits net income, as defined in section 710 (b). In the case of the following corporations, however, the credit with respect to taxable years beginning prior to January 1, 1944, is an amount of which the excess profits tax imposed by Subchapter E of Chapter 2 is 90 percent, and, with respect to taxable years beginning after December 31, 1943, is an amount of which such excess profits tax is 85 percent:

(a) Corporations computing such excess profits tax under section 721, relating to abnormalities in income in the taxable period.

(b) Corporations computing such excess profits tax under section 726, relating to corporations completing contracts under the Merchant Marine Act of 1936.

(c) Corporations computing such excess profits tax under section 731, relating to corporations engaged in mining strategic minerals.

(d) Corporations computing such excess profits tax under section 736 (b), relating to corporations with income from long-term contracts.

For the purpose of the credit in the case of such corporations, the excess profits tax (upon which the credit is to be computed) is the tax imposed under subchapter E of chapter 2 computed without regard to the limitation of tax to 80 percent of surtax net income, as provided in section 710 (a) (1). The excess profits tax is also determined for this purpose without regard to any credit for foreign taxes allowed in section 729 (c) and (d) and without regard to the adjustments provided in section 734.

• • • • •

If the excess profits tax of a corporation imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1941, is finally determined by the use of the excess profits credit based upon constructive average base period net income determined under section 722, or if the corporation is entitled to and used such excess profits credit in the computation of its excess profits tax for such year without the necessity of filing an application for relief on Form 991 (revised January, 1943) under section 722 (see section 35.722-5 (d) of Regulations 112), the credit under section 26 (e) allowable in computing the normal tax and surtax shall be the amount of the corporation's adjusted excess profits net income, as defined in section 710 (b), computed with the use of the excess profits credit based upon constructive average base period net income. However, if such corporation computes its excess profits tax as provided in (*a*), (*b*), (*c*), or (*d*) of this section, the credit under section 26 (e) with respect to taxable years beginning

prior to January 1, 1944, shall be the amount of which the excess profits tax imposed by Subchapter E of Chapter 2, computed as provided by the second paragraph of this section, is 90 per cent, and with respect to taxable years beginning after December 31, 1943, shall be the amount of which such excess profits tax so computed is 95 percent.

Treasury Regulations 112, Promulgated Under the Internal Revenue Code of 1939, January 25, 1944:

Sec. 35.722-2 *Constructive Average Base Period Net Income.*—

* * * * *

(c) *Excess profits credit based on constructive average base period net income.*—For any excess profits tax taxable year for which a constructive average base period net income has been determined under the provisions of section 722 and of this section, the excess profits credit based on income shall be an amount equal to—

(1) 95 percent of the constructive average base period net income determined under section 722;

* * * * *

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 751

MUTUAL SHOE COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 12–18) is reported at 25 T. C. 477. The opinion of the Court of Appeals (R. 25–33) is reported at 238 F. 2d 729.

JURISDICTION

The judgment of the Court of Appeals was entered on November 9, 1956. (R. 33.) The petition for a writ of certiorari was filed on February 5, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the courts below were correct in holding that, where relief with respect to excess profits taxes

has been allowed to a corporation under Section 722 of the Internal Revenue Code of 1939,[1] the credit for income tax purposes allowable under Section 26 (e) is an amount equal to its adjusted excess profits net income resulting *after* the grant of that relief.

STATUTE AND REGULATIONS INVOLVED

Pertinent portions of Sections 13, 15, 26, 710, 711, 712, 713, 714, 722, 728, and 729 of the Internal Revenue Code of 1939, Section 29.26–4 of Treasury Regulations 111, and Section 35.722–2 of Treasury Regulations 112, are set forth in the Appendix, *infra*, pp. 12–24.

STATEMENT

For present purposes, the pertinent facts (R. 10–11, 12–13) may be stated as follows:

Under date of April 10, 1951, the Commissioner, in accordance with the requirements of Sections 272 and 732 of the Code, by registered letter (R. 5–8), gave notice to the taxpayer of the allowance in part of its applications for relief under Section 722 for its fiscal years ended May 31, 1943, 1944, and 1945. The partial allowance resulted in overassessments of excess profits taxes for those years in certain specified amounts (aggregating approximately $10,500). By the same letter, the Commissioner also advised the taxpayer of the determination of income tax deficiencies for those years in certain amounts (aggregating approximately $5,300). (R. 5, 7, 11, 12.)

[1] All Code references herein are to the Internal Revenue Code of 1939.

Thereafter, the taxpayer instituted this proceeding in the Tax Court, seeking a redetermination of the specified income tax deficiencies.[2] (R. 2–3.)

Before the Tax Court, the only controversy was as to the amount properly allowable to the taxpayer as a credit under Section 26 (e) of the Code. (R. 12.) It was stipulated that, if it should be held that this credit is the adjusted excess profits net income determined without the allowance under Section 722, then there are no deficiencies in income tax; while, if it should be held that the credit is the adjusted excess profits net income after the allowance under Section 722, then the Commissioner's determination of income tax deficiencies is correct. (R. 11.)

The Tax Court (upon a review of the case by the entire court, with no dissents) decided in favor of the Commissioner, upholding the deficiencies. (R. 12–18.) The Court of Appeals unanimously affirmed. (R. 25–33.)

ARGUMENT

This is a case, concededly one of first impression (Pet. 4, 5), in which taxpayer, by a selective reading of Section 26 (e) of the 1939 Internal Revenue Code (Appendix, *infra*, pp. 14–15), is seeking an extraordinary exemption from taxation. As a result of its success in obtaining an adjustment of its excess profits tax liability, taxpayer seeks to have corporate income relieved, not only from the excess profits tax, but also from the normal income tax as well. As the court below

[2] The excess profits tax liability of the taxpayer was not placed in controversy. (See R. 13, and Pet. 5.)

observed (R. 32–33), such an exemption is not to be lightly inferred.

An examination of the intermeshed statutory provisions and their legislative history demonstrates the correctness of the decision below rejecting taxpayer's contention. Moreover, the decision below is in conformity with specific provisions of applicable Treasury Regulations and consistent with all other decisions involving comparable situations. There is no adequate ground shown for review by this Court.

1. Properly rejecting the taxpayer's contention that it was entitled for income tax purposes to compute its credit under Section 26 (e) without regard to the excess profits tax relief it was granted under Section 722 (Appendix, *infra*, pp. 18–22), both courts below correctly sustained the Commissioner's position that the grant of relief and the use of a constructive average base period net income under Section 722 reduced the amount of income subjected to the excess profits tax and that therefore there must be a corresponding reduction in the amount of the credit allowable to the taxpayer under Section 26 (e) for income tax purposes. (R. 13–15, 29–33.) As both courts below held, the credit allowed to a corporation for income tax purposes under Section 26 (e), in an amount equal to its adjusted excess profits net income, must necessarily be decreased when there is a decrease in the adjusted excess profits net income by reason of the allowance of relief under Section 722 with respect to the excess profits tax.

Clearly, the effect of the credit under Section 26 (e) is to eliminate from the imposition of income taxes under Chapter 1 that portion of a corporation's income which is being subjected to the excess profits tax under Chapter 2. See also Sections 13 (a) and 15 (a) (Appendix, *infra*, pp. 12–13). Section 26 (e) states, in plain terms, that a corporation shall be allowed a credit in "an amount equal to its adjusted excess-profits net income (as defined in section 710 (b))." And the "adjusted excess-profits net income (as defined in Section 710 (b))" is the income upon which the excess profits tax is imposed by Section 710 (a) (Appendix, *infra*, p. 15). In other words, the "adjusted excess profits net income (as defined in Section 710 (b))" determines both the amount of the credit for income tax purposes and the amount of the excess profits tax. Section 710 (b) (Appendix, *infra*, p. 16) defines "adjusted excess profits net income" as the "excess profits net income" (as defined in Section 711), minus the total of three items, consisting of (1) the specific exemption, (2) the excess profits credit allowed under Section 712[3] (Appendix, *infra*, p. 17) and (3) the unused excess profits credit adjustment.

When relief is granted under Section 722, the excess profits tax is determined by the use of a constructive average base period net income, in lieu of the average base period net income otherwise determined

[3] This credit, which relates to the computation of excess profits taxes, must of course be distinguished from the credit allowed under Section 26 (e). The latter credit, although dependent in part on the credit under Section 712, relates to the computation of income taxes.

for the corporation under Section 713 (Appendix, *infra*, pp. 17–18, 18–19). The grant of Section 722 relief is thus reflected, by the use of the constructive average base period net income, in the computation of the excess profits credit, which, as the second item under Section 710 (b), enters into the computation of the "adjusted excess profits net income" upon which the excess profits tax is imposed. See *supra*, p. 5. Therefore, it necessarily follows that, where the excess profits credit is increased as the result of a grant of relief under Section 722, the adjusted excess profits net income must correspondingly be decreased; and consequently the credit under Section 26 (e), for the purpose of Chapter 1 income taxes, must similarly be decreased.

As the court below pointed out (R. 30), the taxpayer's contention really rests on nothing more than an argument to the effect that, in order to avoid the result for which the taxpayer contends, Congress should have made a specific cross-reference in Section 26 (e) to an adjustment for Section 722 relief—such as, perhaps, by having Section 26 (e) provide for the allowance of a credit in "an amount equal to its adjusted excess-profits net income (as defined in section 710 (b), *or as adjusted by reason of the application of Section 722*)." The adding to Section 26 (e) of the italicized language, however, would have been wholly superfluous since, in a case where Section 722 relief is granted, the excess profits tax is still computed upon the Section 710 (b) formula (*supra*).

Strong support for the conclusion below is also to be found in Section 722 (g) (Appendix, *infra*, pp. 21–22), whereby Congress required annual reports to be made by the Commissioner (and to be published in the Federal Register), as to each taxpayer allowed relief under Section 722 (by the Commissioner or by the Tax Court), showing, among other things, the increase in the excess profits credit allowed and "the amount of the gross reduction in the tax under this subchapter [*i. e.*, the excess profits tax] and of the gross increase in the tax under Chapter 1, which results from the operation of this section." Congress clearly intended, and required unequivocally, that the reports should reflect the increase in income tax which would result from the granting of Section 722 relief as to excess profits tax. See H. Rep. No. 871, 78th Cong., 1st Sess., pp. 57–58 (1944 Cum. Bull. 901, 944); S. Rep. No. 627, 78th Cong., 1st Sess., p. 74 (1944 Cum. Bull. 973, 1027). See also Treasury Department's Bulletin on Section 722 of the Internal Revenue Code, Bureau of Internal Revenue (November 1944), pp. 161–162. As the court below correctly pointed out (R. 32), the increase in Chapter 1 income tax under the circumstances "could only come about from an adjustment of the credit in § 26 (e)."

2. Contrary to the taxpayer's assertion (Pet. 5, 6, 9–10) that Congress "deliberately rejected it" (Pet. 5), the legislative history furnishes emphatic support to the correctness of the conclusion below. It is clear that Congress, by the 1942 changes in the law, intended to prevent the double burden, upon the same income of corporations, of the Chapter 1

income taxes and the Chapter 2 excess profits tax, and for that purpose chose the device of dividing the corporate income into two parts, one of which was to be subjected to the excess profits tax while the other was to be subjected to the income tax. But, on the other hand, Congress certainly intended to tax, by one tax or the other, all corporate income, and did so by providing specifically that all of the income not subjected to the excess profits tax would be subject to the income tax. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 18, 65 (1942–2 Cum. Bull. 372, 388, 423); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 66–67 (1942–2 Cum. Bull. 504, 556); and H. Conf. Rep. No. 2586, 77th Cong., 2d Sess., pp. 2, 36 (1942–2 Cum. Bull. 701, 702). See also Senate Hearings before the Committee on Finance, Revenue Act of 1942, pp. 34, 38, 39.

As already pointed out (*supra*, p. 5), the general rule prescribed by Section 26 (e) is that the credit for income tax purposes is to be measured by the formula set forth in Section 710 (b)—namely, the excess profits net income less the total of the specific exemption, the excess profits credit, and the unused excess profits credit adjustment. Congress, however, made an exception to this general rule with respect to corporations whose excess profits tax was to be computed, not upon the formula of Section 710 (b), but rather by one of the special formulas allowed under Sections 721, 726, 731, and 736 (b). As to these corporations, Section 26 (e) provided that the credit for income tax purposes be based upon the amount of the excess profits tax actually imposed

(*i. e.*, a credit in an amount of which the tax under the designated section would be 95—originally 90—per cent). Pointing (Pet. 9–10) to the fact that the House had originally proposed including Section 722 within this exception provision, while the Senate later eliminated it from the exception provision and the House finally agreed, the taxpayer contends (Pet. 10) that the "legislative record, therefore, fully supports" its position.

But there is no basis whatever for assuming that the elimination of Section 722 from the exception provision was due to a desire to have the law provide that, as the taxpayer claims, a corporation which is granted Section 722 relief should nevertheless be allowed a credit for income tax purposes unadjusted in conformity with the Section 722 relief. On the contrary, even the committee reports quoted by the taxpayer (Pet. 9–10) show that Section 722 was eliminated from the exception provision only because "[c]orporations reconstructing average base period net income under section 722 * * *, by reason of the amendments made to section 722 * * *, will come under the general rule making the credit under section 26 (e) the amount of adjusted excess profits net income." S. Rept. No. 1631, *supra*, p. 67 (1942–2 Cum. Bull, 556); H. Conf. Rep. No. 2586, *supra*, pp. 2, 36 (1942–2 Cum. Bull. 702). And, as shown (*supra*, pp. 5–6), the application of the general rule under Section 26 (e) to "[c]orporations reconstructing average base period net income under section 722" necessarily results in a reduced income tax credit, since the effect of Section 722 relief is to increase the excess

profits credit and since the latter credit is an integral part of the Section 710 (b) formula.

3. The Commissioner's position in this case, as the court below observed (R. 32), is further fortified by an explicit provision relative to the specific point in controversy in Section 29.26-4 of Treasury Regulations 111 (Appendix, *infra*, pp. 22–24). If the matter were otherwise doubtful, the Regulations would in themselves support the conclusion below. *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 501. See also *Advance Aluminum Cast. Corp.* v. *Commissioner*, 168 F. 2d 353 (C. A. 7th).

4. The decision below is in keeping with all other decisions which, in comparable situations, have dealt with the adjustment to be reflected in the credit allowable under Section 26 (e) in this respect. See *Advance Aluminum Cast. Corp.* v. *Commissioner*, 168 F. 2d 353, 355 (C. A. 7th); *Morrisdale Coal Mining Co.* v. *Commissioner*, 21 T. C. 393, 395; *Pine Hill Crystal Spring Water Co.* v. *United States*, 121 F. Supp. 480, 483 (S. D. N. Y.). See also *West End Furniture Co.* v. *Commissioner*, 6 T. C. 557.

In addition, as also recognized by the court below (R. 33), this Court in its opinion in *United States* v. *Koppers Co.*, 348 U. S. 254, twice pointed out (fns. 7 and 16, pp. 259, 266–267) that an adjustment of excess profits taxes under Section 722 would *automatically* leave more of a corporation's income subject to the normal income tax and surtax. Petitioner's assertion of conflict with *Koppers* (Pet. 5, 7–9), rests upon nothing more than a purely artificial analysis of the significance of the holding there made by this

Court with respect to the nonretroactive character of the Section 722 adjustment[*]—a matter having no bearing or significance here.

CONCLUSION

The decision below is correct. There is no conflict of decisions, and no question calling for review by this Court is presented. Accordingly, it is respectfully submitted that the petition for certiorari should be denied.

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APRIL 1957.

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[*] It may be noted, incidentally, that this point as to retroactivity is made by the taxpayer for the first time in this Court.

APPENDIX

INTERNAL REVENUE CODE OF 1939

CHAPTER 1—INCOME TAX

* * * * *

Subchapter B—General Provisions

Part I—Rates of Tax

* * * * *

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) [as amended by Sec. 201 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 105 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Definitions.*—For the purposes of this chapter.

(1) *Adjusted net income.*—The term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(2) *Normal-tax net income.*—The term "normal-tax net income" means the adjusted net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b).

(b) [as amended by Sec. 101 (a) of the Second Revenue Act of 1940, c. 757, 54 Stat. 974] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income of every corporation the normal-tax net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231 (a),

Supplement G, or Supplement Q) whichever of the following taxes is the lesser:

(1) [as amended by Sec. 103 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General rule.*—A tax of 24 per centum of the normal-tax net income; or

* * * * *

(26 U. S. C. 1952 ed., Sec. 13.)

SEC. 15 [as amended by Sec. 105 (a) and (b) of the Revenue Act of 1942, *supra*]. SURTAX ON CORPORATIONS.

(a) *Corporation Surtax Net Income.*—For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26 (h). * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the corporation surtax net income of every corporation (except a Western Hemisphere Trade Corporation as defined in section 109, and except a corporation subject to the tax imposed by section 231 (a), Supplement G, or Supplement Q), a surtax as follows:

(1) *Surtax net incomes not over $25,000.*—Upon corporation surtax net incomes not over $25,000, 10 per centum of the amount thereof.

(2) *Surtax net incomes over $25,000 but not over $50,000.*—Upon corporation surtax net incomes over $25,000, but not over $50,000, $2,500,

plus 22 per centum of the amount of the corporation surtax net income over $25,000.

(3) *Surtax net incomes over $50,000.*—Upon corporation surtax net incomes over $50,000, 16 per centum of the corporation surtax net income.

* * * * *

(26 U. S. C. 1952 ed., Sec. 15.)

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) [as amended by Sec. 105 (d) of the Revenue Act of 1942, *supra*, and Sec. 202 (c) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Income Subject to Excess-Profits Tax.*—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b)). In the case of any corporation computing such tax under section 721 (relating to abnormalities in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736 (b) (relating to corporations with income from long-term contracts), the credit shall be the amount of which the tax imposed by such subchapter is 95 per centum. For the purpose of the preceding sentence the term "tax imposed by Subchapter E of Chapter 2" means the tax computed without regard to the limitation provided in section 710 (a) (1) (B) (the 80 per centum limitation), without regard to the credit provided in section 729 (c) and (d) for foreign taxes paid, and without regard to the adjustments

provided in section 734. This subsection shall not apply to any corporation exempt from such tax under section 725 or section 727.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 26.)

CHAPTER 2—ADDITIONAL INCOME TAXES

* * * * * *

Subchapter E—Excess Profits Tax

[As added by Sec. 201 of the Second Revenue Act of 1940, *supra*, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940".]

SEC. 710. IMPOSITION OF TAX.

(a) [as amended by Sec. 201 (a) of the Revenue Act of 1941, *supra*, and Sec. 202 of the Revenue Act of 1942, *supra*] *Imposition.*—

(1) *General rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) [as amended by Sec. 202 (a) of the Revenue Act of 1943 *supra*] 95 per centum of the adjusted excess profits net income, or

(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter).

* * * * *

(b) *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in Section 711) minus the sum of:

(1) [as amended by Sec. 204 (a) of the Revenue Act of 1943, *supra*] *Specific exemption.*—A specific exemption of $10,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under Section 712; and

(3) [as amended by Sec. 2 (a) of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and by Sec. 204 (a) of the Revenue Act of 1942, *supra*] *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

* * * * *

(26 U. S. C. 1952 ed., Sec. 710.)

SEC. 711. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

(A) [as amended by Sec. 206 (a) of the Revenue Act of 1942, *supra*] *Income Subject to Excess Profits Tax.*—In computing such normal-tax net income the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter) shall not be allowed;

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(26 U. S. C. 1952 ed., Sec. 711.)

SEC. 712 [as amended by Sec. 13 of the Excess Profits Tax Amendments of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 712.)

SEC. 713. EXCESS PROFITS CREDIT—BASED ON INCOME.

(a) *Amount of Excess Profits Credit.*—The excess profits credit for any taxable year, computed under this section, shall be—

(1) *Domestic corporations.*—In the case of a domestic corporation—

(A) [as amended by Sec. 228 (e) (2) of the Revenue Act of 1942, *supra*] 95 per centum of the average base period net income.

(b) [as amended by Sec. 204 (b) of the Excess Profits Tax Amendments of 1941, *supra*] *Base Period.*—

(1) *Definition.*—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preced-

ing the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

* * * * *

(26 U. S. C. 1952 ed., Sec. 713.)

SEC. 714 [as amended by Sec. 205 of the Revenue Act of 1943, *supra*]. EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL.

The excess profits credit, for any taxable year, computed under this section, shall be the amount shown in the following table:

If the invested capital for the taxable year, determined under section 715 is:	The credit shall be:
Not over $5,000,000.	8% of the invested capital.

* * * * *

(26 U. S. C. 1952 ed., Sec. 714.)

SEC. 722 [as amended by Sec. 222 (a) of the Revenue Act of 1942, *supra*]. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

(a) *General Rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu

of the average base period net income otherwise determined under this subchapter. * * *

(b) *Taxpayers Using Average Earnings Method.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer entitled to use the excess profits credit based on income pursuant to section 713, if its average base period net income is an inadequate standard of normal earnings because—

(1) in one or more taxable years in the base period normal production, output, or operation was interrupted or diminished because of the occurrence, either immediately prior to, or during the base period, of events unusual and peculiar in the experience of such taxpayer,

(2) the business of the taxpayer was depressed in the base period because of temporary economic circumstances unusual in the case of such taxpayer or because of the fact that an industry of which such taxpayer was a member was depressed by reason of temporary economic events unusual in the case of such industry,

(3) the business of the taxpayer was depressed in the base period by reason of conditions generally prevailing in an industry of which the taxpayer was a member, subjecting such taxpayer to

(A) a profits cycle differing materially in length and amplitude from the general business cycle, or

(B) sporadic and intermittent periods of high production and profits, and such periods are inadequately represented in the base period,

(4) the taxpayer, either during or immediately prior to the base period, commenced business or changed the character of the business and the average base period net income does not reflected the normal operation for the entire base period of the business. * * * or

(5) of any other factor affecting the taxpayer's business which may reasonably be considered as resulting in an inadequate standard of normal earnings during the base period and the application of this section to the taxpayer would not be inconsistent with the principles underlying the provisions of this subsection, and with the conditions and limitations enumerated therein.

(c) *Invested Capital Corporations, Etc.*—The tax computed under this subchapter (without the benefit of this section) shall be considered to be excessive and discriminatory in the case of a taxpayer, not entitled to use the excess profits credit based on income pursuant to section 713, if the excess profits credit based on invested capital is an inadequate standard for determining excess profits because—

(1) the business of the taxpayer is of a class in which intangible assets not includible in invested capital under section 718 make important contributions to income,

(2) the business of the taxpayer is of a class in which capital is not an important income-producing factor, or

(3) the invested capital of the taxpayer is abnormally low.

In such case for the purposes of this subchapter, such taxpayer shall be considered to be entitled to use the excess profits credit based on income, using the constructive average base period net income determined under subsection (a). * * *

(d) [as amended by Sec. 1 of the Act of December 17, 1943, c. 346, 57 Stat. 601] *Application for Relief Under This Section.*—The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in section 710 (a) (5). The benefits of this subsection shall

not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitation as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter for a subsequent taxable year.

* * * * *

(g) [as added by Sec. 206 of the Revenue Act of 1943, *supra*] The Commissioner shall compile for each fiscal year beginning after June 30, 1941, by internal revenue districts, and alphabetically arranged, all cases in which relief has been allowed during such year under the provisions of this section by the Commissioner and by The Tax Court of the United States, as the case may be. Such compilation shall contain the name and address of each taxpayer to which relief has been so allowed, the business in which the taxpayer is engaged, the amount of the excess profits credit before such allowance, the increase in such credit claimed, the increase in such credit allowed, and the amount of the gross reduction in the tax under this subchapter and of the gross increase in the tax under Chapter 1, which results from the operation of this section. In the case of relief allowed by The Tax Court of the United States, the Commissioner shall also set forth the data previously reported under this subsection with respect to relief previously

allowed in such case by the Commissioner. Such compilation shall be published in the Federal Register.

(26 U. S. C. 1952 ed., Sec. 722.)

SEC. 728. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

(26 U. S. C. 1952 ed., Sec. 728.)

SEC. 729. LAWS APPLICABLE.

(a) *General Rule.*—All provisions of law (including penalties) applicable in respect of the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 729.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> SEC. 29.26–4 [as amended by T. D. 5401, 1944 Cum. Bull. 204, 206]. *Credit for Income Subject to Excess Profits Tax.*—A credit is provided in section 26 (e) allowable under sections 13 (a) (2) and 15 (a) in computing normal tax net income and surtax net income, respectively. See section 108 as to certain fiscal years. The credit is allowed only in the case of corporations subject to the excess profits tax imposed by subchapter E of chapter 2. The credit does not apply to a corporation exempt from such tax under section 725 (relating to personal service corporations) or section 727 (relating to corporations exempt from excess profits tax).
>
> In general, the credit is the amount of the corporation's adjusted excess profits net income, as defined in section 710 (b). In the case of the following corporations, however, the credit with respect to taxable years beginning

prior to January 1, 1944, is an amount of which the excess profits tax imposed by Subchapter E of Chapter 2 is 90 percent, and, with respect to taxable years beginning after December 31, 1943, is an amount of which such excess profits tax is 95 percent:

(a) Corporations computing such excess profits tax under section 721, relating to abnormalities in income in the taxable period.

(b) Corporations computing such excess profits tax under section 726, relating to corporations completing contracts under the Merchant Marine Act of 1936.

(c) Corporations computing such excess profits tax under section 731, relating to corporations engaged in mining strategic minerals.

(d) Corporations computing such excess profits tax under section 736 (b), relating to corporations with income from long-term contracts.

For the purpose of the credit in the case of such corporations, the excess profits tax (upon which the credit is to be computed) is the tax imposed under subchapter E of chapter 2 computed without regard to the limitation of tax to 80 percent of surtax net income, as provided in section 710 (a) (1). The excess profits tax is also determined for this purpose without regard to any credit for foreign taxes allowed in section 729 (c) and (d) and without regard to the adjustments provided in section 734.

* * * * *

If the excess profits tax of a corporation imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1941, is finally determined by the use of the excess profits credit based upon constructive average base period net income determined under section 722, or if the corporation is entitled to and used such excess profits credit in the computation of its excess profits tax for such year without the necessity of filing an application

for relief on Form 991 (revised January, 1943) under section 722 (see section 35.722–5 (*d*) of Regulations 112), the credit under section 26 (e) allowable in computing the normal tax and surtax shall be the amount of the corporation's adjusted excess profits net income, as defined in section 710 (b), computed with the use of the excess profits credit based upon constructive average base period net income. However, if such corporation computes its excess profits tax as provided in (*a*), (*b*), (*c*), or (*d*) of this section, the credit under section 26 (e) with respect to taxable years beginning prior to January 1, 1944, shall be the amount of which the excess profits tax imposed by Subchapter E of Chapter 2, computed as provided by the second paragraph of this section, is 90 per cent, and with respect to taxable years beginning after December 31, 1943, shall be the amount of which such excess profits tax so computed is 95 per cent.

Treasury Regulations 112, promulgated under the Internal Revenue Code of 1939:

SEC. 35.722–2 *Constructive Average Base Period Net Income.*—

* * * * *

(c) *Excess profits credit based on constructive average base period net income.*—For any excess profits tax taxable year for which a constructive average base period net income has been determined under the provisions of section 722 and of this section, the excess profits credit based on income shall be an amount equal to—

(1) 95 percent of the constructive average base period net income determined under section 722;

* * * * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 751

MUTUAL SHOE COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

---

REPLY BRIEF FOR THE PETITIONER TO BRIEF IN OPPOSITION BY THE RESPONDENT

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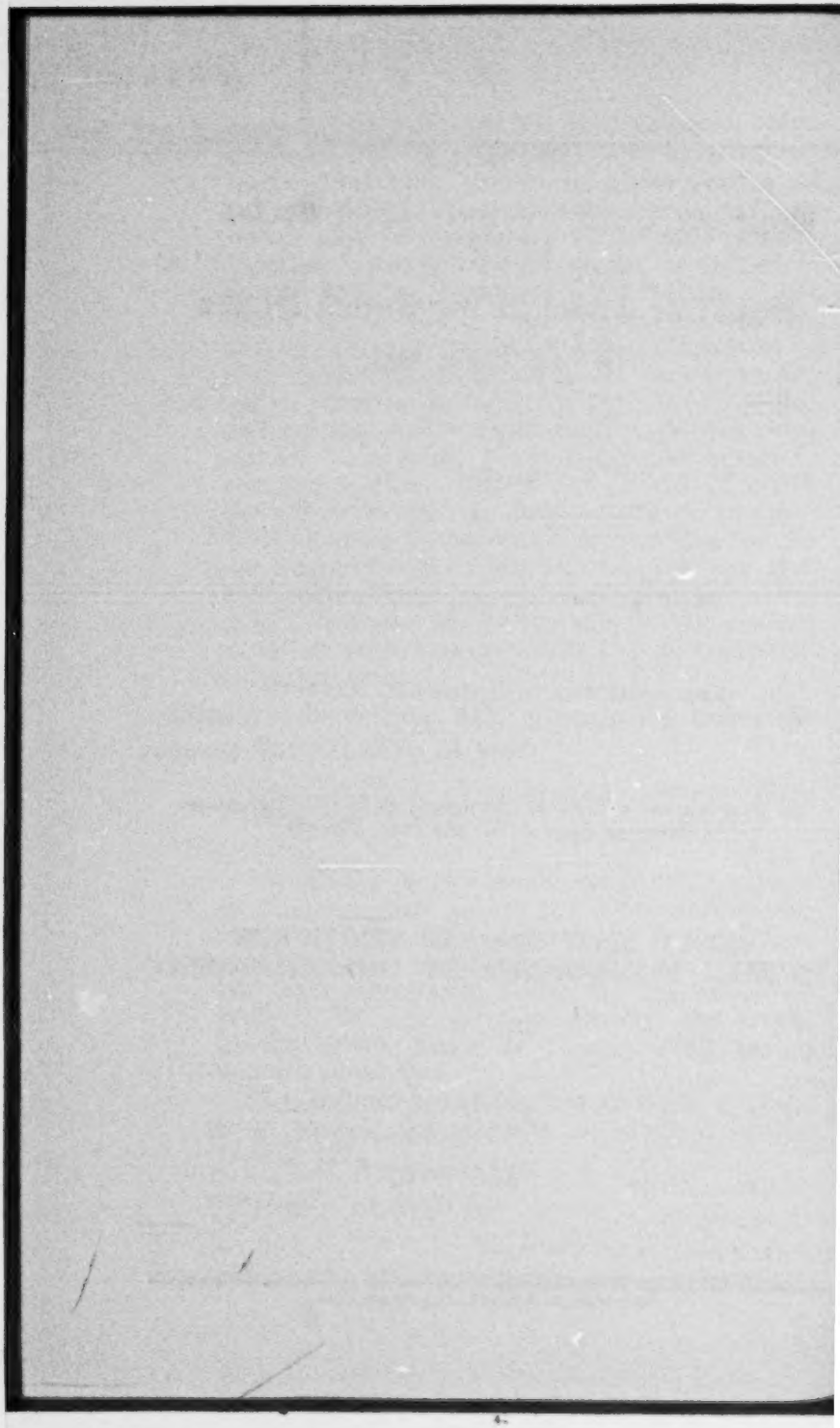

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ARGUMENT

The Respondent in his brief in opposition to the Petition for a writ of Certiorari concludes that the nonretroactive character of the Section 722 adjustment is a matter that has no bearing or significance here. (Res. Br. 11)

We submit that this Court's holding in *United States* v. *Koppers Co.* (348 U.S. 254) and its construction of the language of Section 722 set forth at pages 263-4

and quoted in the petition (p. 8) is of the utmost significance. It does have a bearing and significance here—it goes to the very root of the relief sought by the petitioner.

If the decision by this Court in *United States* v. *Koppers Co.* (*supra*) is correct—and we believe it is—this petitioner is entitled to the relief sought.

Also of significance is footnote 13 in *United States* v. *Koppers Co.* (*supra*) appearing at page 264 of the United States Reports wherein this Court in support of its "looking forward" and holding the application of Section 722 of the Internal Revenue Code of 1939 to be not retroactive states:

> "Section 722(d) looks forward when it provides that if a constructive base period net income has been determined under § 722 for any taxable year, the Commissioner may, by regulations approved by the Secretary, permit waivers of the section's limitations for the purpose of determining excess profits taxes for a subsequent taxable year. Even this effect is not automatic, whereas it might have been expected to be so if the adjustment were a retroactive correction of the standard excess profits credit."

CONCLUSION

The decisions below are in direct conflict with the holding of this Court in *United States* v. *Koppers Co.* (*supra*). Accordingly, it is respectfully submitted that the petition for certiorari should be granted.

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No. 751

MUTUAL SHOE COMPANY, *Petitioner*

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PETITION FOR REHEARING ON ORDER DENYING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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PETITION FOR REHEARING ON ORDER DENYING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Mutual Shoe Company, by its undersigned attorney, respectfully prays for a REHEARING on the Order of this Court, promulgated on April 22, 1957, denying a petition for a writ of Certiorari to the United States Court of Appeals for the First Circuit.

GROUNDS FOR REHEARING

We believe that rehearing should be granted pursuant to Rule 58-2 of the Rules of this Court within the rationale of *Schriber-Schroth Co.* v. *Cleveland Trust Co.* (305 U.S. 47, 50) on the grounds that:

(1) This case is on all fours with the construction this Court placed on Section 722 of the Internal Revenue Code of 1939 as amended in *United States* v. *Koppers Company, Inc.* (348 U.S. 254, 263-4), wherein it held that Section 722 of the Internal Revenue Code was not retroactive in application and that interest on a refund did not accumulate from the date of payment of the tax; but only from the time of allowance of such Section 722 claims.

Here, in the case at bar, the question of retroactivity relates to the assertion of an additional income tax that has no basis in law unless Section 722 does have retroactivity.

This Court, by denying Certiorari here, does one of two things: It denies the petitioner the benefit of the law as this Court has proclaimed it; or, it creates a conflict—not within the Circuits, but within this Court itself—that should be resolved.

If *United States* v. *Koppers Co., Inc.* (supra) is overruled, this petitioner, the bar, and the Courts should know it. If *United States* v. *Koppers Co., Inc.* (supra) is not overruled, this petitioner is being denied equal justice under law; and if *United States* v. *Koppers Co., Inc.* (supra) is to be distinguished, this petitioner should have an opportunity to be heard, and the bar and lower Courts should know the basis of such distinguishment, so that the law will have the clarification it needs.

It is significant to note that *United States* v. *Koppers Co., Inc.* (supra) was decided on January 31, 1955. Of the Justices sitting on that date, six are still members of the Court—Chief Justice Warren and Justices Black, Frankfurter and Clark formed part of the majority sitting. Justices Reed and Douglas dissented. Justices Jackson, Minton, and Burton have been succeeded by Justices Harlan, Brennan and Whittaker.

(2) There are other cases in the hands of the undersigned counsel in which he has advised the withholding of suit pending the outcome of this case. Should such suits be decided in a manner to conflict with the First Circuit Court of Appeals, but not with the decision of this Court in *United States* v. *Koppers Co., Inc.* (supra), such conflict will arise at a time when it will be too late for the petitioner to reopen this case.

WHEREFORE, it is prayed that this Court will remand its Order denying certiorari and grant certiorari in this case.

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Attorney for Petitioner

Certificate

CARL J. BATTER, Counsel for petitioner, certifies that this Petition for Rehearing is filed in good faith and not for delay; in fact, there is no occasion for delay since the petitioner, if successful, will have released to him monies in excess of the amount at issue here now withheld by the Government pending the outcome of this case; and, under no circumstances, can the petitioner be required to disgorge any monies; and

FURTHER CERTIFIES that this petition is restricted to the single question of whether the change in the composition of the membership of the Court changes the rule of law proclaimed by this Court less than twenty-eight months ago in *United States* v. *Koppers Co., Inc.* (*supra*), respecting the retroactivity of Section 722 of the Internal Revenue Code of 1939 as amended.

CARL J. BATTER
Counsel for Petitioner